



June 2, 2003

Honorable Mayor and City Council:

The Scottsdale City Budget for Fiscal Year 2003/04 keeps Scottsdale fiscally sound during the most challenging economic period in the City's history.

As outlined in my original transmittal letter for the draft budget in March (see pages 3-10 of this section), the City is entering an unprecedented third year of declining revenues amid continued economic uncertainty. FY 2003/04 revenue projections show declines in many of the City's significant revenue sources, such as privilege tax, transient occupancy tax, state-shared revenues and development permits and fees.

Despite these challenges, the budget continues to fund essential services, maintains investment in critical capital projects and carries forward Scottsdale's emergency reserve fund. To bring the budget into balance, the City has reduced the size of its workforce, trimmed employee programs and fringe benefits, reduced the General Fund subsidy to transportation projects and adopted a more realistic and better-defined Capital Improvement Program.

The adopted FY 2003/04 budget essentially carries forward the March budget proposal with some modifications, based on public input and City Council directives. The most significant changes are noted below:

- **General Fund Operating Contingency.** The City Council requested and adopted a \$1 million increase in the General Fund Operating Contingency, which increased the proposed operating contingency budget amount from \$1.5 million to \$2.5 million.
- **Property Tax Rate.** The City's overall real property tax rate was adopted at \$1.12 per \$100 of assessed value. This change represents a 3 cent reduction from the prior year tax rate.
- **Culture Quest.** Based on community input and City Council members' direction, funding for Culture Quest continues for FY 2003/04 at \$770,000.
- **Transit Services.** The City Council voted to restore \$674,700 in funding for transit services set to be cut in the proposed budget. Because of the restored funding, the Transit Division will continue the Maricopa County Special Transportation Services, continue Express Route 510, and maintain the current weekday peak-hour and midday schedules on Scottsdale and Miller roads. As noted by staff during the public input process, the funding source used to restore these transit services in FY 2003/04 will not be available in subsequent years.
- **WestWorld Covered Arena and Walkway to the Equidome.** The adopted FY 2003/04 capital budget includes \$577,000 to restore a covered arena and walkway project not in the initial five-year capital plan.
- **Capital Improvement Plan Update.** In the time between the transmittal of the proposed budget and the final budget adoption, work on several capital projects progressed and used available funds in FY 2002/03. As a result, the amount to be carried over to the FY 2003/04 capital budget was reduced by \$9.5 million. The new, lower total for the capital budget is \$495.5 million.

The end of one budget process marks the beginning of another. During the next 12 months, staff will closely track the national, state and local economies and report any new trends. This information will be used in developing the proposed budget for FY 2004/05. The City's responsiveness to emerging economic challenges and its careful long-range planning

have been key factors in Scottsdale's fiscal health. Despite actual FY 2002/03 revenues that lagged behind adopted budget estimates, the City spotted the trend early enough to cut expenditures without affecting services.

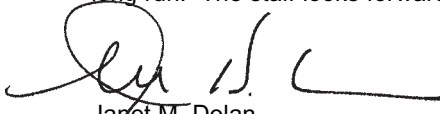
The City's financial management has earned Scottsdale the highest possible ratings from the three major bond-rating agencies since 2001. Scottsdale remains among a few exceptional local governments nationwide with similar ratings. This fact is especially noteworthy because many communities across the country have tapped into their financial reserves as revenues dropped, and their ratings have been downgraded. Scottsdale did not use its General Fund Reserve in FY 2002/03 and has not assumed any use of the reserve to balance the FY 2003/04 budget.

The adopted budget is the culmination of the diligent efforts of many people. Special recognition goes to the Financial Services staff for their outstanding management of City finances and the budget development process.

The Citizens Budget Review Committee deserves acknowledgment for the many months they volunteered to learn about the City's finances and complete an intensive review of the program and capital budgets.

Finally, a note of thanks goes to the Mayor and City Council for your guidance on many critical budget issues and for the time you devoted to hear from representatives of civic and cultural organizations, transit users, neighborhood groups and other members of the public.

The economic turbulence of the past several years has highlighted the importance of Scottsdale's continuing efforts to build a sustainable local economy. The Morrison Institute study, "Which Way Scottsdale?" highlighted some of the critical questions the City must answer to make its economy less reactive to events on the national level and more stable in the long run. The staff looks forward to continuing this vital work with the City Council and the entire community.



Janet M. Dolan
City Manager



March 12, 2003

Honorable Mayor and City Council:

The Proposed FY 2003/04 Scottsdale City Budget is designed to meet the economic challenges confronting the City in the next budget year and to prepare Scottsdale for future challenges.

The City is entering an unprecedented third year of declining revenues. There is continuing uncertainty about the timing and magnitude of an economic recovery. Developing the proposed budget required difficult choices to achieve a budget that balances the following objectives: (1) delivering quality services expected by residents and businesses (2) continuing innovation to help manage costs, (3) striking a balance between current expectations and investing in the City's future needs and economic generators, and (4) ensuring sound fiscal practices.

The proposed budget and the related Five-Year Financial Plan for each of the City's funds assume conservative economic forecasts and limited revenue growth. At this point in the City's history, this is the only prudent approach. Not only is the timing of an economic recovery uncertain, it is not likely to generate the level of economic expansion and double-digit revenue increases that Scottsdale experienced in the 1990s. Slower revenue growth means Scottsdale must carefully weigh the costs and benefits of all programs. As the community evolves, the City must be able to sustain basic municipal services at high levels of quality. At the same time, Scottsdale's government must be flexible enough to reallocate staff and resources from programs that have served their purpose into new initiatives that meet emerging needs and mission critical programs.

In developing the proposed budget, City staff followed a zero-based program budget approach leading to a focused review of services delivered by the City, increased scrutiny of expenditures and prioritization of programs to be funded using limited resources. Key features of the draft budget include:

- An \$8.8 million decrease in expenditures and transfers-out of the General Fund, the largest fund, which supports basic City services. Expenditures and transfers-out will decline from an estimated FY 2002/03 year-end level of \$204.3 million to \$195.5 million in FY 2003/04.
- Externally driven personnel cost increases due primarily to increases in City retirement contributions and health care insurance premiums. Increases in retirement contributions are estimated at \$3.4 million, and increases in health care costs are estimated at \$2.6 million.
- An annualized reduction of \$2.6 million in personnel costs through the elimination of 41 vacant positions. Of the total, 32 positions will come from the General Fund, where revenues are influenced significantly by the economy.
- Additional measures to control personnel costs, including the elimination of across-the-board pay increases, elimination or reduction of several fringe benefits and employee programs and a reduction of about \$1.4 million in training, travel and business conference expenditures.
- A more realistic and precise plan for continued investment in the City's basic infrastructure and public facilities, combined with a more comprehensive analysis of associated maintenance and operating costs. Improved cash management and other changes in the proposed Capital Improvement Plan will ensure that the City can take advantage of favorable financing and construction markets to build key projects and phase in operating costs for new facilities at a reasonable pace.

- A reduction in General Fund subsidies to transportation. The draft budget proposes a change in financial policies that would allow the City to use up to 40 percent of the .2 percent Transportation Privilege (Sales) Tax for operations that support improvements to the City's transportation system. Reductions in transit services also are proposed. Both proposals will reduce the General Fund subsidy to transportation.
- Sustained funding of the General Fund ten-percent reserve to ensure the City can provide basic services in the event of major emergencies. The reserve is also very important in retaining the City's triple AAA bond ratings.
- An estimated five-cent drop in the combined property tax rate, from \$1.15 to \$1.10 per \$100 in assessed valuation.
- An average increase of only about \$1.50 in the average homeowner's combined bill for water & sewer, refuse, and recycling services.

This initial draft budget does not account for two significant factors that could affect the final budget. As more information becomes available, it will be presented:

- A change in the allocation of state shared revenues. So far, the Legislature has not moved forward with cuts to shared revenues. The City continues to monitor the state's budget proposals.
- Approval of voter initiatives to implement a municipal fire department by November 2003. A staff task force is refining a detailed plan for the transition, if voters approve the initiatives. Cost estimates drawn from the plan are expected within the next week, and will include analyses of one-time transition costs and any differences between the current fire services budget and the budget for a municipal fire department.

While the City Council will be reviewing and adopting budgets for all of the City's various funds, the major focus of this document will be on the General Fund. The General Fund is the City's largest fund and includes revenue sources that are typically the most unpredictable. The General Fund pays for traditional municipal services, such as police and fire protection, parks, libraries, and social services. This fund provides the core services available to all citizens, and therefore warrants the most attention during the budget review process.

The draft budget includes more than 180 programs, which represents a significant expansion over the staff's initial efforts last year to identify costs by program. The goal of the program budget is to provide the City Council and citizens a more focused analysis of the costs of each City service or function. Each program budget includes a program description, services provided, City Council's Broad Goals supported by the program, a multi-year summary of its budget and staffing, customers, program broad goals and objectives and performance measures.

A summary of programs by department is included so the reader can see a department's total budget and the proportions of the budget and staff dedicated to specific programs. This summary is intended to enhance the level of public discussion and participation in the prioritization of programs and resources to achieve the City Council's Broad Goals reaffirmed at the October 2002 council workshop.

The following is a summary of budget highlights. A more detailed analysis of the all the City's funds and their applicable program budgets is included in the accompanying attachments.

General Fund Revenues

As noted above, the General Fund is the core service delivery budget and the largest fund with the highest potential for revenue fluctuations. The estimates in this proposal reflect a very conservative and cautious assessment of revenues due to the uncertainty regarding the national, state, and local economies and the possibility of war. With consumer confidence at an all-time low, the timing and degree to which a recovery may specifically impact Scottsdale's economy is impossible to predict. The proposed budget is based on projections that Scottsdale's population will continue to grow at an annual rate of 1.8 percent, and annual inflation will be approximately 2.0 percent for the coming fiscal year.

The overall General Fund revenues and transfers-in to the fund are expected to decline from \$201.2 million, the current year-end estimate, to \$195.6 million in FY 2003/04, a decrease of \$5.6 million or 2.7 percent. The following General Fund revenues represent the most significant changes between fiscal years:

- Transaction Privilege (Sales) Tax – This revenue source represents the 1.0 percent General Fund share of the City's 1.4 percent sales tax. Of the remaining 0.4 percent of the sales tax, 0.2 percent is dedicated to transportation and 0.2 percent to preservation. These taxes flow into the City's Special Revenue Funds. The Transaction Privilege (Sales) Tax is the City's single largest revenue source. It is estimated to decrease from the FY 2002/03

year-end estimate by \$1.8 million, or 2.2 percent, to \$78.2 million in FY 2003/04. The decrease in the Transaction Privilege (Sales) Tax represents a continued and significant reversal of a long-standing trend of dramatic increases in sales tax revenue. Prior to FY 2001/02, the City saw nine consecutive years of double-digit growth in sales tax revenue. The decline in the FY 2003/04 revenue is estimated to be on par with the current year decline – attributable to the level of economic uncertainty anticipated to continue into next year. The tentative nature of the national and state economies, employment instability resulting in less spending by consumers, and the threat of a war in the Middle East and related acts of terrorism make it impossible to predict with certainty when this revenue source might improve. Looking beyond FY 2003/04, the Five-Year Financial Plan does not foresee a return to double-digit increases of the past and projects instead a slow and very modest increase in sales taxes – essentially keeping pace with very modest inflation.

- Property Taxes – This revenue source is one of the few stable General Fund revenues and is anticipated to increase by \$1.1 million over the current year end estimate, or 7.1 percent, to \$16.5 million. The increase in revenue is driven by a combination of increases in property values and the addition of new construction.
- Transient Occupancy (“bed”) Tax – This revenue source is expected to remain flat with the FY 2002/03 year-end estimate of \$6.7 million. Again, the ongoing uncertainty regarding the economy, the negative impacts of a potential war and/or acts of terrorism are likely to continue suppressing business and pleasure travel. Increased competition from new resorts in neighboring jurisdictions also limits the likelihood of growth in this revenue source in FY 2003/04.
- State-Shared Revenues (“Intergovernmental Revenues”) – These revenues are projected to decrease by \$4.9 million, or 13.2 percent, from the current year-end estimate of \$37.2 million to \$32.3 million. These revenues are from state sales and income taxes and are shared with Arizona cities and towns. The projections for these revenue sources are conservative and based on a soft economy and lower actual income taxes reported to the state. The estimates do not factor in any reductions resulting from legislative changes or reductions.
- Development Permits and Fees - These revenues are projected to decrease by \$750,000, or 5.3 percent, to \$13.5 million. Slowing in development and construction during the current year is expected to continue into next fiscal year.

General Fund Expenditures

The proposed General Fund budget reflects the focused effort of the City staff to hold down spending with an increased emphasis on funding the City’s mission critical priorities. The proposed General Fund budget reflects the elimination of 32 full-time equivalent positions (FTE’s) through attrition, the majority of the 41 total FTE’s (all funds) eliminated from the City workforce in FY 2002/03. If additional staff is required in a program to meet City Council’s Broad Goals, staff is reallocated from existing programs in the various City departments.

Overall General Fund expenditures and transfers-out of the fund decrease 4.3 percent, or \$8.8 million, from an estimated 2002/03 fiscal year-end estimate of \$204.3 million to \$195.5 million. Using a zero-based program budget approach, non-mission critical expenditures have been eliminated and increases in other areas have been held down to help offset market price increases for goods and services needed to continue City business. The reduction in General Fund expenditures is especially noteworthy in light of the sizable increases in the City’s required contribution to the Arizona State Retirement System, the increased costs of health care insurance premiums and the effects of the employees’ FY 2002/03 market pay adjustment. The following represent significant expenditure and transfers-out items:

- Eliminated Positions – The payroll and benefits associated with the 32 eliminated General Fund positions reduce the proposed budget by \$2.0 million annually. In addition, the City will save nearly \$600,000 through a reduction in contract positions in the General Fund. Redeploying staff should minimize any service level impacts.
- Elimination and Reduction of Employee Programs – The reduction and elimination of various employee benefits and programs generates additional budget savings. Examples of these programs and the applicable savings include: elimination of vacation trade and unscheduled leave incentive pay (\$506,000), reduction of superior performance pay (\$459,000), reduction of tuition assistance (\$50,000), elimination of self-managed team pay (\$110,000) and elimination of miscellaneous minor fringe benefits (\$50,000).
- No Market Pay Adjustment – The proposed FY 2003/04 budget does not include a market pay adjustment for any employees. Each 1.0 percent market adjustment in General Fund salaries equates to a \$1.0 million budget increase.

- Transfers-Out – The overall amount of transfers-out to other funds decreases by \$13.3 million or 55.1 percent to \$10.8 million. The proposed transfer to the CIP for various capital and maintenance projects decreases \$6.2 million to \$7.5 million. The reduction in the CIP transfer is attributable to the City's capital project rejustification process and the related modifications to the CIP cash management. The transfer to the Highway User Revenue Fund decreases by \$7.8 million to \$2.5 million. The reduction is premised on a proposed financial policy change that would allow up to 40 percent of the .2 percent Transportation Privilege (Sales) Tax dollars to be used for operating costs that support improvements to the City's transportation system. The remaining 60 percent of the .2 percent Transportation Privilege (Sales) Tax dollars would continue to be transferred to the CIP. Finally, \$750,000 is transferred to the Self-Insurance Fund. The transfer is needed to meet actuarial funding recommendations and rising insurance costs since September 11, 2001.
- Public Safety (Police) – The police department will establish a Repeat Offender Program in an effort to better address burglary and vehicle thefts. The creation of this new program will be accomplished by redeploying four officers by eliminating the DARE Program and three from other police programs at a net cost increase of only \$40,000. Scottsdale will continue its commitment to providing School Resource Officers at high schools and ensuring schools receive drug awareness and safety information.
- Public Safety (Fire) – The fire budget includes \$1.2 million of contractual increases primarily for union negotiated firefighter pay adjustments. It also includes \$300,000 for new firefighter positions to staff a new fire station located at Jomax and Scottsdale Roads, scheduled to open in the fall of 2003.
- Culture and Tourism – The General Fund includes no increases in contract costs for the Scottsdale Convention and Tourism Bureau or the Scottsdale Cultural Council. However, the proposed budget increases funding for the Culture Quest program and continues the downtown lighting program begun during the 2002 holiday season.

General Fund Balances and Reserves

The proposed FY 2003/04 budget includes the following fund balances and reserves:

- General Fund Reserve – This reserve continues the City's financial policy of setting aside funds to protect Scottsdale in times of emergency. This is the City's "savings account," and it is important to note that most of these funds are from "carry over," and once they are spent, it will be difficult, if not impossible, to rebuild the reserve. It is financially prudent to have a minimum General Fund Reserve of 10 percent of total annual operating costs for the General and Highway User Revenue funds. Based on the revenue and expenditure estimates included in the proposed budget, the ending FY 2003/04 General Fund Reserve is projected to be \$ 20.7 million, which equals approximately the current estimate for the FY 2002/03 ending balance. Because of ongoing economic challenges, the proposed budget does not set aside additional reserve funds. Maintaining this reserve is very important to the municipal credit rating agencies and in retaining the City's triple AAA bond ratings.
- Economic Investment Reserve - The proposed budget uses a portion of the annual \$5.0 million balance set aside by the City Council for strategic economic development investments that demonstrate clear returns to the community. In FY 2003/04, funds from this reserve and revenue from the Tourism Development Fund are proposed to be used to provide initial financing for the Loloma Museum. Once the City taps the Economic Investment Reserve for its first-year funding for each economic investment, it shifts the continued funding into the appropriate area of the operating budget. For example, funds for the Culture Quest program during the current budget year come from the Economic Investment Reserve, but continued funding has been included in the Economic Vitality Department budget. Continued funding to finance the Loloma Museum project will be included in the operating budget after FY 2003/04.
- Operating Contingency – The proposed budget includes a \$1.5 million operating contingency to meet unforeseen expenses during the year.
- Unreserved Fund Balance - After considering all of the other reserves, an ending unreserved fund balance of \$1.4 million is projected, which represents cumulative General Fund revenues not designated for a specific purpose. The City Council may choose to allocate some or all of these dollars to funding new or expanded programs or requests, or to allocate it to reserve funds.

General Fund Budget Options for City Council Consideration

Two key policy issues, which are integral parts of the General Fund budget assumptions, are noted below. Both assumptions relate to transportation funding, which has direct impacts on the General Fund but is accounted for in the Highway User Revenue Fund (a Special Revenue Fund outlined later in this summary). Proposed changes to the City's comprehensive financial policies are presented for your review:

- Use of .2 Percent Transportation Privilege (Sales) Tax – As noted above, the proposed General Fund transfers-out (subsidy) to the Highway User Revenue Fund decreases by \$7.8 million to \$2.5 million. The reduction is premised on the City Council's adoption of a financial policy change that would allow up to 40 percent of the .2 percent Transportation Privilege (Sales) Tax to be used for operations that support improvements to the City's transportation system. It should be noted that the current Capital Fund balance and projected cash flows would allow for the continuation of all priority transportation CIP projects.
- Reductions in Transit Program – The proposed budget reflects service reductions in the Transit Program. The proposed transit service reductions focus on reducing frequency of service on bus routes that travel along Scottsdale Road, Hayden Road, Via Linda and Granite Reef. The only route being eliminated in its entirety is Express Route 510, which runs from McCormick Parkway and Hayden Road into downtown Phoenix. Transit programs that serve seniors and people with disabilities will remain a priority.

Based on current revenue and expenditure projections and assuming City Council's adoption of the 40 percent funding policy and the Transit Program reductions, the General Fund could essentially eliminate its subsidy to the Highway User Revenue Fund by the fifth year of the Five-Year Financial Plan.

Special Revenue Funds

The City accounts for revenues earmarked for specific purposes – by law or City policy – through special revenue funds. The largest uses, by far, are transportation and preservation.

Transportation programs are accounted for in two separate funds, the Highway User Revenue Fund and the Transportation Privilege Tax Fund. The Highway User Revenue Fund accounts for the main transportation operating expenditures, which include \$10.7 million for the City's transportation program provided by the Municipal Services Department (street and signal operations and maintenance) and \$9.4 million provided by the Transportation Department (transportation master planning, transit, traffic engineering and intelligent transportation systems).

The revenues and transfers-in to the Highway User Revenue Fund are expected to decrease by \$1.3 million from the FY 2002/03 year-end estimate of \$24.6 million to \$23.3 million, or 5.3 percent. The largest source of revenue into this fund is the Highway User Revenue Tax ("gas tax"), which is designated specifically for transportation purposes. Shared gas taxes are expected to increase by about \$400,000 from \$13.1 million to \$13.5 million. Local Transportation Assistance Fund Revenue ("state lottery") included in the fund is expected to remain flat from the current year revenue estimate of \$1.1 million. Transfers-in to the fund are projected to decrease by \$1.6 million from \$10.3 million to \$8.7 million. The proposed budget for the Highway User Revenue Fund reflects the proposed policy change that would allow the City's .2 percent Transportation Privilege (Sales) Tax to be used for operating costs that support improvements to the City's transportation system. For FY 2003/04, this change will mean a contribution of \$6.2 million from sales taxes to cover transportation operating costs.

Revenue to the Transportation Privilege Tax Fund is expected to decrease about \$100,000 from the current fiscal year-end estimate of \$16.1 million to \$16.0 million in FY 2003/04. The decrease is due to projected lower sales tax collections. All of the revenues in this fund are transferred to other funds for transportation purposes. As noted above, \$6.2 million will go to the Highway User Revenue Fund to pay for operating costs supporting transportation improvements and \$9.8 million will go to the Capital Improvement Plan for transportation related capital projects.

Revenue to the Preservation Privilege Tax Fund also is expected to decrease slightly from the current fiscal year-end forecast of \$16.6 million because of lower sales tax collections. Total expenditures and transfers-out of the fund are estimated at \$16.8 million compared to \$17.3 million in the current year. The primary expenditure of this fund is \$900,000 for debt service payment on the preservation bonds, with the remainder going to the fund balance of \$19.2 million, which has been accumulating for several years. The fund balance will be needed to pay additional debt service over the next few years. The City expects to issue \$50 million in preserve bonds in March of 2004 and an additional \$15.4 million in preserve bonds in March of 2005. Current preserve purchase plans are moving ahead and conservative revenues estimates, coupled with revised debt issuance plans, forecast no long-term negative impact on this special revenue fund.

A collection of smaller restricted revenues for specific City services is included in the Special Programs Fund (Special Revenue). These funds make up the balance of the revenues and expenditures covered under the special revenue funds category. The services included in these various funds are intended to be fully self-supporting and not subsidized by the General Fund. Total revenues and transfers-in and expenditures and transfers-out for these funds are estimated at \$3.6 million and \$3.2 million, respectively. Examples of these funds, which cover a variety of departments and services, include the Police Department (RICO), City Court (Court Enhancement Fund), parks (McCormick-Stillman Railroad Park), libraries (Library Book Sales), senior and social services (Scottsdale Cares). All revenues not expended during the fiscal year carry over to the following year.

Enterprise Funds

Enterprise funds account for the City's water & sewer, solid waste collection and aviation services, operated as stand-alone businesses, where user fees cover the cost of services. The total for revenue and transfers-in to these funds increases from a 2002/03 fiscal year-end estimate of \$106.4 million to \$120.9 million in FY 2003/04, under the proposed budget.

The most significant impacts on the Water & Sewer Funds continue to be compliance by 2006 with the new federal mandates to reduce arsenic levels in drinking water, and another forthcoming mandate to reduce levels of by-product compounds from chlorine disinfection. In this past year, the City began a trial project to help determine the most effective and efficient method to meet federal standards. However, the Five-Year Financial Plan still anticipates the need to issue over \$100 million in debt in future years to pay these mandated costs. The proposed budget includes a modest 3 percent user fee increase to help pay for these added costs.

The Water & Sewer Funds draft budget proposes future debt of \$18.4 million and a small increase, 2.5 percent, in residential sewer rates to fund expansion and upgrades to wastewater treatment facilities.

No increase is proposed in fees for Solid Waste Fund operations for refuse collection and recycling services.

Under the new rates, the average monthly residential utility bill for water & sewer and refuse service would increase about \$1.50 per month.

The Aviation Fund proposes an increase in landing fees that will help pay for operational costs and, in conjunction with grant revenues, fund several capital projects at the airport. The five-year forecast for this enterprise is for continued positive operations and no further subsidy by the General Fund.

Enterprise Fund(s) Policy Changes for City Council Consideration

Several reserve changes are proposed for the Enterprise Funds. The changes are of significant importance for the implementation of a long-range financial plan for the Water & Sewer Funds. Under the plan, the Water & Sewer Funds balance and reserves should meet three objectives: 1) ensure adequate funding for operations; 2) ensure infrastructure repair and replacement; and, 3) provide for incremental and affordable rate changes for customers over time. The long-range water & sewer financial plan focuses on preserving two reserves: 90-day operating reserve and an infrastructure repair/replacement reserve (as required by our bond indenture). Remaining funds will be used only to accumulate cash for future infrastructure projects and level rate impacts to customers over time. These accumulated funds (working capital) currently total nearly \$94 million. The proposed draw-down of accumulated cash is in accordance with the water & sewer multi-year financial plan. The cash will be used for major capital improvement projects planned many years ago.

A positive financial position is forecasted for both the Solid Waste Fund and Aviation Fund and operational reserves are recommended for both enterprise funds. A positive fund balance in the Solid Waste Fund is a result of retired debt, slower growth and stable landfill pricing. It is recommended that a 90-day operating reserve be established to provide future funding to address emergencies and the real possibility of significant future landfill cost increases.

A positive financial position is forecasted for the Aviation Fund due to changes in operations and addition of new landing fees. A 90-day airport operating reserve is also recommended for consideration to provide for emergencies, provide funding for potential grant matches and ensure that further General Fund subsidies are avoided.

Internal Service Funds

Internal Service Funds account for services and equipment provided to all City departments by centralized divisions – for the City's vehicle fleet and a Self-Insurance Fund.

Most of the revenues and transfers-in for these two funds are derived from internal charges to City departments and are budgeted at \$17.4 million for FY 2003/04. About \$640,000 comes from property taxes specifically levied to cover the cost of tort judgments. Another \$460,000 comes from interest earnings and other miscellaneous sources.

The budget for the Self-Insurance Fund of \$5.2 million is relatively flat, with the FY 2002/03 year-end estimate, due to the actual claims and associated costs remaining level. However, the fund is receiving a \$750,000 transfers-in from the General Fund to meet actuarial funding recommendations and rising insurance costs since the September 11, 2001 terrorist attacks.

The Fleet Management Fund includes expected increases in fuel costs of approximately \$150,000 and the costs associated with retrofitting the police vehicles with fuel tank bladders equals about \$368,000. These cost increases are being offset by expected savings due to a revised fleet policy on types of vehicles used, expected useful life of vehicles and reductions in take-home use of City vehicles. Based on these policy changes, the Fleet Management Fund will be transferring \$3.0 million of excess fund balance to the Capital Improvement Plan.

Debt Service Fund

Debt service funds are designated for payment of long-term debt not paid through General, Enterprise or Special Revenue funds.

The total for revenues and transfers-in to these funds equals \$43.8 million for FY 2003/04, an increase of \$3.2 million from the \$40.6 million the current year end estimate. The same amount is expended to meet debt service payments. Reductions are due to re-evaluation of the City's Capital Improvement Plan, related cash flow requirements and revision of proposed bond issuances related to the Bond 2000 general obligation bond authorization.

Property taxes levied to pay for voter-approved bonds are the largest revenue source, providing \$24.5 million in FY 2003/04. The proposed budget projects the rate for "secondary" property taxes, the portion of property taxes specifically dedicated for bonds, will fall slightly from 65 cents to 62 cents per \$100 valuation.

Debt service funds also receive revenue from special district assessments and pay for special district debt service. The remaining revenues in these funds are from interest earnings and miscellaneous sources.

Capital Improvement Plan

A separate, key component of the annual financial plan is the City's Five-Year Capital Improvement Plan (CIP) for infrastructure and public facilities – including roads, water & sewer improvements, parks, buildings and information technology.

During better economic times, previous capital project budgets were, simply put, very optimistic. Prior budgets reflected a very aggressive plan to move projects forward. The proposed Five-Year Capital Improvement Plan uses newly developed conservative financial forecasts and reflects only those projects seen as having the highest priority and the most realistic expectation for completion during the next five years. The proposed Capital Improvement Plan demonstrates a more conservative and workable plan for the foreseeable future. It does not raise expectations that the City will soon begin lower priority projects or projects that the operating budget will not support. This does not mean these remaining projects will not be completed. It merely means the projects not included in the new Five-Year Capital Improvement Financial Plan will be kept on a pending projects list to be incorporated in a later year when financial forecasts improve.

The proposed budget includes \$7.5 million of funding from the General Fund. This represents a decrease of \$6.2 million in funding from the FY 2002/03 year-end estimate. The proposed reduction to transfers-in from the General Fund is a result of the new capital project rejustification process undertaken this year and the ability to adjust capital cash flow requirements to better match actual capital spending. The total proposed CIP appropriation for FY 2003/04 equals \$507.6 million.

The City faces an "interesting" financial situation: an extremely favorable bond market offset by the worst recession in Scottsdale's history. The proposed five-year plan reflects an attempt to continue (and even expedite) projects with minimal

near-term operational impacts – to help direct money into the local economy, complete needed projects and take advantage of the favorable bond market. At the same time, the proposed plan defers many projects that have significant operational impacts – to help us address the current economic downturn, the expectation for little or no near-term recovery, and more conservative long-term financial forecasts.

Also included in the proposed Capital Improvement Plan are administrative changes that will assist in better management of cash flows and project expenditure tracking. For example, where feasible, projects that formerly had multiple funding sources – such as bonds and the .2 percent Transportation Privilege (Sales) Tax – will move to a single funding source. This change improves the management of cash flows for the various funding sources, resulting in better planning of bond issuances, federal arbitrage compliance, and citizen property tax impacts. Without this change, the allocation of expenditures to different funding sources is based on assumptions that do not always provide a reliable estimate of the amount and timing for future bond issuances. One positive outcome of this approach for taxpayers is a plan that forecasts the combined property tax rate dropping from \$1.15 to \$1.10 per \$100 assessed value in FY 2003/04 and staying at or below \$1.12 for the next five years. This is 38 cents, or 25 percent, below the \$1.50 financial policy limit initiated with the Bond 2000 authorization.

Conclusion

The extensive information provided in this proposal provides the basis for a comprehensive discussion over the next few months, when the City Council and the public will have the opportunity to gain more insight into the budget development process and the City's financial picture.

In summary, the primary goals of this challenging budget development process have been to:

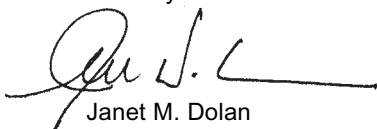
- Use conservative and realistic revenue forecasts.
- Reduce the number of staff positions and redeploy staff to mission critical programs
- Use a zero-based program budget approach to justify and reduce expenditures while still focusing on achieving City Council's Broad Goals and providing basic City services.
- Focus on continuing mission critical programs and eliminating or reducing funding to less critical programs.
- Continue to fund needed investment in the City's infrastructure and facilities.
- Continue to plan for the future through the prudent investment of City resources in strategic economic development investment that demonstrates a clear return to the community.
- Maintain minimum financial reserves.

It is appropriate to thank the City staff, especially Chief Financial Officer Craig Clifford, Budget Director Art Rullo and the entire Financial Services staff, who have put much time and expertise into the development of the proposed budget. The staff has been working on this document since adoption of the FY 2002/03 City Budget, when the first steps of this budget review process began. Departments have worked closely with the Financial Services staff and senior management in developing, documenting and reviewing every component of this proposal. The staff has embraced the City Council's Broad Goals in building a financial plan that delivers the highest quality services at the most reasonable cost to the residents and businesses of Scottsdale.

Over the coming weeks, the Citizen Budget Review Committee will be devoting many hours to understand and analyze the proposed budget and offer their perspectives and insights. Their input is an important part of the budget development process.

The City Council is scheduled to begin its formal review of the proposed budget on March 31, when the staff will present the Capital Improvement Plan during a work-study session. Several other work-study sessions are scheduled. The City Council is scheduled to adopt a tentative budget on May 19 and a final budget on June 2, 2003.

The City staff and I look forward to a thorough and thoughtful examination of the FY 2003/04 proposed budget.



Janet M. Dolan